NO. 82-961

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1982

STATE OF SOUTH DAKOTA, EX REL.,
AURORA COUNTY, ET AL.,
Petitioner,

v.

RICHARD B. OLGILVIE AS TRUSTEE
OF THE CHICAGO, MILWAUKEE,
ST. PAUL AND PACIFIC
RAILROAD COMPANY,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

MARK V. MEIERHENRY
ATTORNEY GENERAL
State Capitol
Pierre, South Dakota 57501-5090
Telephone (605) 773-3215

Counsel for Petitioner

QUESTION PRESENTED

Should the general rule against setoff by unsecured creditors in reorganization plans under § 77 of the Bankruptcy Act, established by the case of Baker v. Gold Seal Liquors, 417 U.S. 467 (1974), be rigidly applied to include secured governmental tax creditors?

LIST OF PARTIES

The following counties, all being political subdivisions of the State of South Dakota, were parties in the proceeding before the Court of Appeals for the Seventh Circuit, and said counties are represented by Petitioner, State of South Dakota:

Aurora
Beadle
Bon Homme
Brown
Brule
Campbell
Charles Mix
Clark
Clay
Corson
Davison
Day
Dewey
Douglas
Edmunds
Faulk
Grant
Hamlin
Hanson
Hutchinson
Jackson
Jerauld
Jones
Kingsbury
Lake
Lincoln
Lyman
McCook
McPherson
Marshall
Meade
Miner
Minnehaha
Moody
Pennington
Perkins
Roberts
Sanborn
Spink
Turner
Union
Walworth
Yankton
Ziebach

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OPINION BELOW

The opinion of the United States Court of Appeals for the Seventh Circuit appears in the appendix (Appendix A, pp. A-1 to A-9).

NO. 82-

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1982

STATE OF SOUTH DAKOTA, EX REL., ET AL.,

Petitioner,

v.

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OF THE CHICAGO, MILWAUKEE,
ST. PAUL AND PACIFIC
RAILROAD COMPANY,

Respondent.

PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
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JURISDICTIONAL STATEMENT

On September 3, 1982, the Seventh Circuit Court of Appeals in Chicago entered judgment and

filed an Order affirming the judgment of the United States District Court for the Northern District of Illinois, Eastern Division wherein in an order dated January 14, 1980, the District Court had granted Respondent's Motion for Summary Judgment and had denied the relief requested in Petitioner's Complaint.

This Court's jurisdiction is invoked under 28 U.S.C. § 1254 and Rules of the Supreme Court No. 20 (1980).

STATUTES INVOLVED

11 U.S.C. § 205 [§ 77 of the Bankruptcy Act]

The relevant portions of the South Dakota Codified Laws are as follows:

> SDCL 10-19-1. All taxes shall become due on the first day of January of the year following that in which such taxes are assessed, and as between vendor and vendee shall become a lien upon real property on and after such date.
>
> SDCL 10-28-1. All property, real and personal belonging to any railroad company in this state actually and necessarily used in the operation of its line or lines of railway in this state

shall be considered as "operating property," and shall be assessed for the purposes of taxation by the secretary of revenue, and not otherwise.

STATEMENT OF THE CASE

On December 20, 1977, the United States District Court for the Northern District of Illinois issued an order in the matter of the Chicago, Milwaukee, St. Paul and Pacific Railroad Company. This order was issued in the course of proceedings for railroad reorganization pursuant to 11 U.S.C. § 205. The order enjoined all persons and other entities from, inter alia, claiming or taking any setoff of any obligation owing to the Chicago, Milwaukee, St. Paul and Pacific Railroad Company against any claim owed by the Chicago, Milwaukee, St. Paul and Pacific Railroad Company. The Petitioner, in May of 1979, commenced the present action in the District Court, seeking relief from the District Court's injunction against setoff.

The Respondent filed a Motion for Summary Judgment, and that motion was granted by the District Court in a decision dated December 5, 1979. The Petitioner's Motion to Reconsider the decision of December 5, 1979, was denied by the District Court on January 11, 1980.

Petitioner then appealed the District Court's decision to the United States Court of Appeals for the Seventh Circuit. On September 3, 1982, the Court of Appeals for the Seventh Circuit entered its judgment and order affirming the judgment of the District Court.

The factual dispute in this case is based on the Chicago, Milwaukee, St. Paul and Pacific Railroad Company having made overpayments on South Dakota real property taxes during 1969 and 1970. Because of these overpayments, the South Dakota counties for whose benefit this action is brought are indebted to the Chicago, Milwaukee, St. Paul and Pacific Railroad Company. Conversely, the Chicago, Milwaukee, St. Paul and

Pacific Railroad Company is indebted to the South Dakota counties in whose name this action was brought for 1977, 1978, 1979, 1980, 1981 and 1982 taxes imposed on the Railroad's "operating property" pursuant to Chapter 10-28-1 of South Dakota Codified Laws. Furthermore, the Railroad's failure to pay taxes assessed triggered the provisions of § 10-19-1 of the South Dakota Codified Laws, which section reads as follows:

> All taxes shall become due on the first day of January of the year following that in which such taxes are assessed, and as between vendor and vendee shall become a lien upon real property on and after such date.

This action was originally brought on in the District Court to allow the South Dakota counties for whose benefit this action is brought to set off the delinquent taxes now due and owing to the counties from the Chicago, Milwaukee, St. Paul and Pacific Railroad Company against any amounts which the counties owe to the Railroad by reason of tax overpayments.

REASONS FOR GRANTING THE PETITION

I

THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT HAS DECIDED AN IMPORTANT QUESTION OF FEDERAL LAW WHICH HAS NOT BEEN, BUT SHOULD BE, SETTLED BY THIS COURT.

In Baker v. Gold Seal Liquors, 417 U.S. 467, 94 S.Ct. 2504, 41 L.Ed.2d 243 (1974), the Trustees of the Penn-Central Transportation Company, acting under § 77 of the Bankruptcy Act, brought suit to recover freight charges from Gold Seal Liquors. Gold Seal, in turn, counterclaimed, seeking to set off damages for loss and damage to shipments over the bankrupt debtor's line. Gold Seal Liquors apparently made no claim to any entitlement of priority, and made no claim of any secured or lien status. The Court held that a setoff should be denied, concluding that to the extent a setoff would have been allowed, it would have granted a preference to the claim of

Gold Seal Liquors over others by the happenstance that Gold Seal Liquors owed freight charges that other creditors did not. 417 U.S. 467 at 474. The majority opinion's reasoning is best exemplified by the following statement found at 417 U.S. 473:

> Secured creditors have by law a priority in the hierarchy. Unsecured creditors usually are pooled together. They may receive new securities, perhaps stock. Allowance of a setoff that reduces all or part of the debtor's claim against them is a form of priority. [Emphasis added].

Petitioners respectfully submit that the underscored word "them" in the above-cited passage clearly refers to unsecured creditors, and that therefore, it is clear that the Court was applying its reasoning to unsecured creditors only. The counties represented by the Petitioner herein are secured tax lien creditors by virtue of the operation of South Dakota law, as set forth above. Petitioner respectfully submits that the Court of Appeals for the Seventh Circuit has, by

affirming the decision of the District Court, violated the principle set forth by this Court in Baker v. Gold Seal Liquors, supra. In its decision affirming the District Court the Court of Appeals for the Seventh Circuit has effectively held that the general rule against allowance of setoffs, established by Baker v. Gold Seal Liquors, applies to secured tax lien creditors as well as unsecured creditors.

The Petitioner, therefore, concludes that the Court of Appeals for the Seventh Circuit has incorrectly claimed that this Court's ruling in Baker v. Gold Seal Liquors, prohibits, as a general rule, setoffs of mutual debts by secured creditors.

The fundamental rule for a reorganization plan under § 77 of the Bankruptcy Act is that the plan must be "fair and equitable." It is clear that a plan, in order to be "fair and equitable," must insure that creditors with priority are in fact treated as such. In the case of Matter of

Central Railroad Co. of New Jersey, 579 F.2d 804 (3rd Cir. 1978), it was stated:

> The priority standard [of § 77] requires that creditors and claimants of a bankrupt estate of the same class receive the full value of their debts from the property of the debtor before junior creditors and shareholders are paid. [Citing Baker v. Gold Seal Liquors, 417 U.S. at 473-474 (1974) 579 F.2d 804 at 810].

This Court, in the case of United States v. Key, 397 U.S. 322, 90 S.Ct. 1049, 25 L.Ed.2d 340 (1970) noted that no plan which compromises the rights of senior creditors in order to protect junior creditors can be found to be "fair and equitable." 397 U.S. 322 at 327.

The order of the Court of Appeals for the Seventh Circuit, in the instant case, strikes too broadly under the rule announced by this Court in Baker v. Gold Seal Liquors, supra, and under the principles of fairness and equitableness required by § 77 of the Bankruptcy Act.

Petitioner respectfully submits that the question of whether this Court's general rule

against the allowance of setoffs in proceedings under § 77 of the Bankruptcy Act should be applied to secured creditors is an important question of federal law which has not been, but should be, settled by this Court.

II

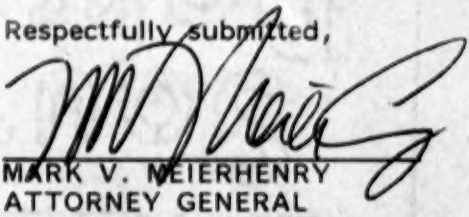
THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT HAS IMPROPERLY APPLIED LAW ESTABLISHED BY THIS COURT.

The United States Court of Appeals for the Seventh Circuit has, in its decision affirming the District Court herein, erroneously claimed that this Court's ruling in Baker v. Gold Seal Liquors, supra, establishes a blanket prohibition against setoffs by both unsecured and secured creditors in proceedings under § 77 of the Bankruptcy Act. In so doing, the Court of Appeals for the Seventh Circuit has improperly applied the law, as established by this Court in Baker v. Gold Seal Liquors, supra.

CONCLUSION

Based on the foregoing arguments and authorities, the State of South Dakota prays that its Petition for Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit be granted.

Respectfully submitted,



MARK V. MEIERHENRY
ATTORNEY GENERAL
State Capitol
Pierre, South Dakota 57501-5090
Telephone: (605) 773-3215
Counsel for Petitioner

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

No. 82-

In the Matter of: Chicago, Milwaukee, St. Paul & Pacific Railroad Company, Debtor.	* * * * *	Appeal from the United States District Court for the Northern District of Illinois, Eastern Division No. 77-B-8999
Appeal of State of South Dakota, etc.	* *	Thomas R. McMillen, Judge.

Submitted: July 30, 1982*

Filed: September 3, 1982

Before CUMMINGS, Chief Judge; BAVER and COFFEY, Circuit Judges.

ORDER

The Chicago, Milwaukee, St. Paul and Pacific Railroad Company (the "Milwaukee Road") filed

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* Pursuant to this court's order of October 29, 1981, upon joint motion of the parties to waive oral argument, this appeal is submitted to the court on the briefs and record. See Circuit Court Rule 14(f).

for reorganization under § 77 of the Bankruptcy Act, 11 U.S.C. § 205 (1976), on December 19, 1977. On December 20, 1977, the Reorganization Court entered "Order No. 1" in the case. Paragraph 10 of that order provided for a stay of all proceedings against the Milwaukee Road, in accordance with Bankruptcy Rule 8-501. Among other things, paragraph 10 enjoined "the setoff of any obligation to the Debtor against any claim owing by the Debtor. . . " In addition, in paragraph 4B of Order No. 1, the court gave the Trustee of the Milwaukee Road discretion to pay or withhold payment of "taxes, assessments and other governmental charges . . ."

Pursuant to his authority under Order No. 1, the Trustee has deferred payment of taxes, for the years 1977 and 1978, to 43 South Dakota counties. By operation of South Dakota law, these counties became lien creditors when the

railroad failed to pay the taxes.[1] Twenty-nine of the creditor counties owe tax refunds to the Milwaukee Road.[2] Rather than pay the full amount of the refunds, these counties wish to set off the back taxes owed to them against the refunds owed by them. Because such setoffs are precluded in paragraph 10 of Order No. 1, South Dakota filed suit on behalf of its counties, seeking relief from the injunction against setoff.[3] The Trustee filed an answer supporting the setoff

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[1] The Trustee concedes that the counties are secured creditors "for purposes of argument only." Appellees' brief at 9.

[2] On November 23, 1977, the South Dakota Department of Revenue issued a directive stating that the Milwaukee Road had overpaid ad valorem taxes for the years 1969 and 1970. The directive ordered the counties that had received the overpayments to refund the money to the railroad. Although some counties complied with this directive, twenty-nine have not done so.

[3] In its complaint, South Dakota also requested judgment in favor of all 43 counties to which the Milwaukee Road owes back taxes. The district court denied such relief. South Dakota has not contested this aspect of the court's order, and it is not addressed here.

injunction, and filed a counterclaim demanding payment of the tax refunds still owing to the Milwaukee Road.

The district court granted summary judgment to the Trustee, refusing to lift the setoff injunction and ordering immediate payment of all tax refunds owed to the Milwaukee Road. South Dakota appealed.

South Dakota's sole ground for appeal is that the district court should have granted a setoff to the tax-creditor counties because the refusal to grant the setoff "violates the principles set forth in the case of Baker v. Gold Seal Liquors, 417 U.S. 467 (1974)." Appellants' brief at 5. We reject this argument.

In Baker, the trustees of the Penn-Central Transportation Company sued respondent for freight charges. Respondent counterclaimed for cargo loss and damage. The district court found in favor of the trustees on the freight-charge

claim and in favor of the respondent on the cargo-loss claim. Over the objection of the trustees, the district court set off one judgment against the other. The Supreme Court reversed, holding that "[a]s a general rule of administration," a setoff should not be allowed in railroad reorganization proceedings under section 77 of the Bankruptcy Act. Id. at 474. The Court reasoned that granting a setoff would grant "a preference to the claim of one creditor over the others by the happenstance that it owes freight charges that the others do not. That is a form of discrimination to which the policy of § 77 is opposed." Ibid.[4]

---

[4] Discussing the policy of § 77, the Court explained that the aim of the Reorganization Court is by financial restructuring to put back into operation a going concern, and that this aim entails two basic considerations:

> First is the collection of amounts owed the bankrupt to keep its cash inflow sufficient for operating purposes, at least at the survival levels. The second

South Dakota argues that Baker's general rule against allowing setoffs in railroad reorganization cases is not applicable here, for two reasons. First, the state asserts, denial of the setoff would deprive the counties of their secured-creditor status. The appellant, however, offers no support for this bald conclusion. The counties' liens on the Milwaukee Road's real property arose by virtue of the railroad's failure to pay taxes when due. That those same counties owe offsetting refunds to the railroad can have no effect whatever on the existence or validity of the tax liens. It follows that the district court's decision that the refunds must be paid in full has no effect on the existence or validity of the tax

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> is to design a plan which creditors and other claimants will approve, which will pass scrutiny of the Interstate Commerce Commission, which will meet the fair-and-equitable standards required by the Act for court approval, and which will preserve an ongoing railroad in the public interest.

Id. at 470-71 (footnotes omitted.)

liens. The counties remain secured creditors; their claims are being treated no differently from the claims of other similarly situated secured creditors.

South Dakota's second argument is that setoff should be granted because it would not result in an unfair preference. This argument reveals the state's misapprehension of the Supreme Court's reasoning in Baker. South Dakota apparently believes that in Baker, granting the setoff to the unsecured creditor resulted in elevating the unsecured creditor to the status of secured creditor, and that this elevation was the "preference" condemned by the Supreme Court. This view is erroneous. The allowance of the setoff in Baker gave the unsecured creditor no security interest in any property of the railroad, but rather gave it the equivalent of immediate payment on part of its claim against the railroad. The "preference" consisted of giving immediate payment to one unsecured creditor while denying

immediate payment to other unsecured creditors. In the present case, granting a setoff to the South Dakota counties would result in a similar preference: the South Dakota counties would receive, effectively, immediate payment on part of their tax claims, while other entities with similar claims secured by liens would not receive immediate payment.

Finally, South Dakota argues that the Trustee's asserted need for cash is insufficient to justify denial of the setoffs because it is "hardly a controlling consideration under the principles enunciated in Baker." But in Baker, the Supreme Court expressly stated that one of the two basic considerations of a Reorganization Court is "the collection of amounts owed the bankrupt to keep its cash inflow sufficient for operating purposes, at least at the survival levels." Id. at 471. Moreover, the Reorganization Court in this case did not, as South Dakota asserts, determine that the Milwaukee Road's asserted need for cash

justified a denial of the South Dakota counties' secured-creditor status. As discussed above, denial of the setoffs does not undermine that status. To the contrary, it ensures that the South Dakota counties will be treated the same as other secured creditors who do not happen to owe money to the railroad. This is the proper result under Baker.

For the foregoing reasons, the judgment of the district court is affirmed.

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STATE OF SOUTH DAKOTA, EX REL.,
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RICHARD B. OLGILVIE AS TRUSTEE
OF THE CHICAGO, MILWAUKEE,
ST. PAUL AND PACIFIC
RAILROAD COMPANY,

Respondent.

SUPPLEMENTAL APPENDIX

MARK V. MEIERHENRY
ATTORNEY GENERAL
State Capitol
Pierre, South Dakota 57501-5090
Telephone (605) 773-3215

Counsel for Petitioner

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UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF ILLINOIS

EASTERN DIVISION

Name of Presiding Judge, Honorable Thomas R. McMille
Cause No. 77 B 8999 Date DEC. 5, 1979
Title of Cause In the Matter CHICAGO, MILWAUKEE, ST. PAUL & PACIFIC R. CO.

Brief Statement of Motion _____

The rules of this court require counsel to furnish the names of all parties entitled to notice of the entry of an order and the names and addressed of their attorneys. Please do this immediately below (separate lists may be appended).

Names and Addresses of moving counsel _____

Representing _____

_____

Names and Addresses of other counsel entitled to notice and names of parties they represent. _____

_____

_____

_____

_____

Enter order No. 26B:

Reserve space below for notations by minute clerk

Trustee's motion for summary judgment on the complaint filed by the State of South Dakota on behalf of its political subdivisions, & Trustee's motion for summary judgment on his counterclaim is granted. The Trustee is ordered to serve & file proposed judgment order within 10 days to which plaintiff may file objections within 10 days thereinafter. (Decision attached)

Hand this memorandum to the Clerk. Counsel will not rise to address the Court until motion has been called.

Unr. Dec.-21

UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF ILLINOIS

EASTERN DIVISION

In the Matter of	)	In Proceedings for the Reorganization of a Railroad
CHICAGO, MILWAUKEE ST. PAUL AND PACIFIC RAILROAD CO.,	)	
Debtor.	)	
STATE OF SOUTH DAKOTA, etc.,	)	
Plaintiff,	)	
STANLEY E. G. HILLMAN, Trustee, etc.	)	NO. 77 B 8999
Defendant.	)	

D E C I S I O N

Plaintiff has filed a complaint in this proceeding seeking relief from this court's Order No. 1, paragraph 10. We find and conclude that defendant is entitled to summary judgment on the complaint, and on his counterclaim.

The Trustee is indebted to various South Dakota counties for taxes due for 1977 and 1978

on the debtor's operating property within that state. The Trustee has admitted tax liabilities in specified amounts. However, the Trustee's counterclaim alleges that 29 of the plaintiff's counties are indebted to him for tax refunds pertaining to the years 1969 and 1970. Plaintiff has admitted the liability for the tax refunds, but has denied the specific amounts due.

Paragraph 4B of this court's Order No. 1 authorizes the Trustee, in his discretion, to pay taxes due upon the debtor's properties. Paragraph 10 of that order prohibits the set-off of any obligation to the debtor against any obligation owed by the debtor. Plaintiff alleges that the Trustee has abused his discretion in failing to pay these property taxes, the plaintiff seeks relief from paragraph 10 of Order No. 1 so that it may set-off the claims for property taxes against the tax refunds due the Trustee.

The affidavits submitted with the Trustee's motion for summary judgment demonstrate that the

Trustee has not abused his discretion in deferring payment of these property tax liabilities. The affidavit of Richard Nugent states that the Trustee has deferred paying more than $13,000,000 in local taxes since the filing of the reorganization petition. This is well within the Trustee's discretion exercised to meet the debtor's continual operating needs for cash.

We must also deny plaintiff's request for relief from paragraph 10, Order No. 1. This court has twice followed the rule of Baker v. Gold Seal Liquors, 417 U.S. 467 (1974), in this proceeding. (Orders No. 191, 196.) To accord plaintiff a modification of Order No. 1 for the benefit of the political subdivisions would effectively vacate paragraph 10 of the order and would impede the Trustee in collecting many of his claims. Allowance of a set-off, in effect, grants a preference to that creditor over others, and this we have consistently declined to do.

The affidavit of Richard Nugent sets forth the amounts due from plaintiff's subdivisions for overpayments made by the debtor in 1969 and 1970. Plaintiff has not contested the accuracy of those amounts in the manner required by F.R.C.P. 56, nor has it filed any response to the Trustee's motion for summary judgment, filed October 5, 1979.

IT IS THEREFORE ORDERED, ADJUDGED AND DECREED that the Trustee's motion for summary judgment on the complaint filed by the State of South Dakota on behalf of its political sbudivisions, and the Trustee's motion for summary judgment on his counterclaim against those political sbudivisions, is granted. The Trustee shall serve and file a proposed judgment order within ten (10) days to which plaintiff may file objections within ten (10) days thereafter.

ENTER:

JUDGE, U.S. DISTRICT COURT

DATED: Dec. 5, 1979

UNITED STATES DISTRICT COURT,

NORTHERN DISTRICT OF ILLINOIS

EASTERN DIVISION

Name of Presiding Judge, Honorable Thomas R. McMillen
Cause No. 77 B 8999 Date JAN. 11, 1980
Title of Cause In the Matter CHICAGO, MILWAUKEE, ST. PAUL & PACIFIC R. CO.

Brief Statement of Motion _____

The rules of this court require counsel to furnish the names of all parties entitled to notice of the entry of an order and the names and addressed of their attorneys. Please do this immediately below (separate lists may be appended).

Names and Addresses of moving counsel _____

Representing _____

_____

Names and Addresses of other counsel entitled to notice and names of parties they represent. _____

_____

_____

_____

_____

Reserve space below for notations by minute clerk

Motion of the State of South Dakota, on behalf of its political subdivisions, to reconsider this court's Order No. 263 is denied. Baker v. Gold Seal Liquors, 417 U.S. 467 (1974) is not limited to unsecured claims (e.g. p. 473). Also, continual need for operating cash pending reorganization justifies this treatment of plaintiff's claims.

ENTER:

/s/ Thomas R. McMillen
JUDGE, U.S. District Court

Hand this memorandum to the Clerk.
Counsel will not rise to address the Court until motion has been called.

No. 82-961

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Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

RESPONDENT'S BRIEF IN OPPOSITION

ROBERT H. WHEELER
(Counsel of Record)
LAWRENCE S. ADELSON
EDWARD W. MALSTROM
ISHAM, LINCOLN & BEALE
Three First National Plaza
Suite 5200
Chicago, Illinois 60602
(312) 558-7500
Counsel for Respondent

January 28, 1983

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Respondent.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

RESPONDENT'S BRIEF IN OPPOSITION

REASONS FOR DENYING THE WRIT

1. The courts below applied law settled by this and other courts that setoffs are not allowed in Section 77 railroad reorganizations.

Paragraph 10 of Order No. 1 in the Milwaukee Road reorganization enjoins setoffs of obligations of the Debtor against claims against the Debtor. Such an order is typical in a railroad reorganization under Section 77.[1] *See, e.g., In re*

[1] 11 U. S. C. § 205 (repealed effective 1979) is referred to herein as Section 77. It continues to govern the Milwaukee Road reorganization. Pub. L. No. 95-598, § 403, 92 Stat. 2683 (1978).

Lehigh and Hudson River Ry. Co., 468 F.2d 430, 432 (2d Cir. 1962); *Penn Central Transp. Co.* v. *National City Bank*, 315 F.Supp. 1281, 1282 (E.D. Pa. 1970), 315 F.Supp. 1281 (E.D. Pa. 1970); *In re Chicago, Rock Island and Pacific R.R. Co.*, 537 F.2d 906, 913 (7th Cir. 1976), *cert. denied*, 429 U.S. 1092 (1977); *In re Central Railroad Co.*, 273 F.Supp. 282, 285 (D.N.J. 1967), aff'd 392 F.2d 589 (3d Cir. 1968).

This Court has stated that "[a]s a general rule of administration for Section 77 Reorganization Courts, setoff should not be allowed." *Baker* v. *Gold Seal Liquors*, 417 U.S. 467, 474 (1974). This rule has been consistently reiterated and followed by other federal courts faced with attempts to set off claims in Section 77 reorganizations.[2] *See In re Lehigh and Hudson, supra*, at 433; *Penn Central Transp. Co.* v. *National City Bank, supra*, at 1283-84; *In re Central R.R. Co., supra.*

The Seventh Circuit simply applied this rule to the case at hand. Petitioners have shown no uncertainty or disagreement in the courts regarding the rule and have made no case for its reconsideration.

2. The rationale of *Baker* v. *Gold Seal* applies to tax claims.

Petitioners argue that the rule against setoffs enunciated in *Baker* v. *Gold Seal* is limited to low-priority unsecured claims and does not apply to tax claims.

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[2] The only exception has been in the specialized area of railroad interline per diem accounts governed by Interstate Commerce Commission regulations. The Seventh Circuit found that such accounts contain only net balances rather than offsetting claims. *In re Chicago, Rock Island and Pacific R.R. Co., supra.*

While *Baker* did involve low-priority unsecured claims, it sets forth a general rule which is not limited to those facts.[3] The *Baker* Court enunciated two reasons for prohibiting setoffs in railroad reorganizations. Both aspects of the *Baker* rationale clearly apply, by logic and by precedent, to the tax claims at issue here. Therefore, there is no reason for this Court to consider this case. The first reason is the need to collect "amounts owed the bankrupt to keep its cash inflow sufficient for operating purposes, . . ." 417 U.S. at 471. It is clear that payment of taxes can be suspended to permit continuation of railroad operations. *In re Penn Central Transp. Co.*, 452 F.2d 1107 (3d Cir. 1971), *cert. denied*, 406 U.S. 944 (1972).

The second rationale is that ". . . to the extent that [a setoff] is allowed, it grants a preference to the claim of one creditor over the others . . . That is a form of discrimination to which the policy of § 77 is opposed." *Baker* v. *Gold Seal*, 417 U.S. at 474. This rationale applies with equal force to tax claims and freight claims. A setoff by a secured creditor wrongly prefers that creditor over other creditors, secured and unsecured, just as surely as a setoff by an unsecured creditor. In an analogous Section 77 case, where railroad property was condemned, the rule of *Baker* against discrimination was applied to prevent preferential payment of taxes out of the proceeds of the condemnation. *In re Penn Central Transp. Co.*, 383 F.Supp. 1128, 1130 (E.D. Pa. 1974).

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[3] The interests of high-priority, secured creditors can be suspended and altered in the interests of a successful reorganization. *New Haven Inclusion Cases*, 399 U.S. 392, 492 (1970); *Penn-Central Merger Cases*, 389 U.S. 486, 510-11 (1968).

CONCLUSION

Based upon the foregoing, Richard B. Ogilvie, Trustee of the Property of the Chicago, Milwaukee, St. Paul and Pacific Railroad Company prays that the Petitioner's Petition for a Writ of Certiorari be denied.

Respectfully submitted,

ROBERT H. WHEELER
LAWRENCE S. ADELSON
EDWARD W. MALSTROM
ISHAM, LINCOLN & BEALE
Three First National Plaza
Suite 5200
Chicago, Illinois 60602
(312) 558-7550
Counsel for Respondent

APPENDIX A

PARENT COMPANIES, SUBSIDIARIES AND AFFILIATES

Richard B. Ogilvie as Trustee of the Property of the Chicago, Milwaukee, St. Paul & Pacific Railroad Company, Debtor, is the Respondent.

Prior to reorganization proceedings, the Chicago Milwaukee Corporation was the parent of the Debtor owning approximately 96% of its common and preferred stock. The Trustee is vested with title to the assets of the Milwaukee Road and is empowered to operate its business and otherwise deal with its assets and properties, subject to the jurisdiction of the Reorganization Court. It is the Trustee's opinion that Chicago Milwaukee Corporation and its subsidiaries are neither parent nor affiliates because the Property of the Milwaukee Road is controlled by the Trustee and the Reorganization Court rather than Chicago Milwaukee Corporation.

AFFILIATES

Chicago Union Station Company
Indiana Harbor Belt Railroad Company
Kansas City Terminal Railway Company
The Minnesota Transfer Railway Company
Minneapolis Eastern Railway Company
The Pullman Company
Trailer Train Company
Longview Switching Company
Northern Tier Pipeline Company

SUBSIDIARIES

Chicago, Terre Haute and Southeastern Railroad Company
Davenport, Rock Island and North Western Railway Company
DesMoines Union Railway Company
Milwaukee Land Company
The Milwaukee Motor Transportation Company
Bremerton Freight Car Ferry, Inc.
MTI, Inc.
Washington, Idaho and Montana Railway Company
MLC Equipment Company
MNT, Inc.